



Public Investment Memorandum

Caspian Keystone Focused Fund Ltd. – Class C
Caspian Focused Opportunities Fund

Public Fixed Income – U.S. Corporate High Yield
Commitment

Allocation Implementation Committee
Approval Date: July 11, 2022



Executive Summary

Carl Lantz, Senior Portfolio Manager, Richard Ko, Senior Investment Professional, and Aksia LLC, (“Aksia”), recommend that the Board commit an amount not to exceed \$500 million plus reasonable normal investment expenses, to the Caspian Keystone Focused Fund Ltd. – Class C share class (the “Fund”, “Caspian HY”, or “Keystone Focused”), a proposed share class under an existing fund-of-one. The Class C share class will mirror the Caspian Focused Opportunities Fund.

IOP is also requesting a full transfer of the existing fund-of-one, inclusive of a Board approved co-investment share class, Caspian Keystone Focused Fund Ltd. – Class A, and a Board approved contingent/drawdown share class, Caspian Keystone Focused Fund Ltd. – Class B, from the Absolute Return asset class to the Traditional Investments – Credit Related: U.S. High-Yield asset class. Both share classes are approved for investments in long-only credit instruments and would be consistent with the strategy mandate of the Traditional Investments – Credit Related: U.S. High-Yield asset class.

Fund Name	Caspian Focused Opportunities Fund
Vehicle Name	Caspian Keystone Focused Fund Ltd. – Class C share class
Firm Name	Caspian Capital LP
Target Fund Size / Capacity	Target \$2.7 billion in the strategy
Recommended Commitment Amount	\$500 million
Existing Relationship	Yes
Asset Class / Sub Asset Class	Fixed Income / U.S. High Yield
Investment Office Professionals Due Diligence Team (“IOP”)	Carl Lantz, Senior Portfolio Manager Richard Ko, Senior Investment Professional
Investment Office Oversight	Carl Lantz, Senior Portfolio Manager
External Consultant Oversight	Aksia LLC
ESG Policy (Y / N)	Yes

Firm Overview

Caspian Capital LP (“Caspian”) launched in 1997 on the Mariner Investment Group (“Mariner”) platform as a stressed credit and capital structure arbitrage fund managed by Mark Weissman. Adam Cohen, the current lead portfolio manager, joined in 2001. Caspian became a stand-alone entity in December 2007 when the manager spun-out from Mariner and independently launched the Caspian Select Credit Fund (“Caspian Select Credit”), which is currently the firm's flagship offering. Caspian Select Credit broadly follows the same strategy as the one employed at Mariner but has tilted closer toward a long-only approach in recent years.

Today, Caspian manages approximately \$3.8 billion across the Select Credit strategy (\$1.6 billion in a commingled fund and \$415 million in pari-passu accounts), \$1.7 billion in long-only mandates including the Caspian Focused Opportunities Fund, and \$627 million of capital committed to a closed-end dislocation fund. The Caspian Focused Opportunities Fund was launched in August 2011 as a Separately Managed Account. It was converted into a commingled fund in September 2021.



PSERS' history with Caspian is as follows:

- In November 2010, the Public School Employees' Retirement System Board approved the recommendation of PSERS' Investment Office Professionals and Aksia to invest \$200 million in the long/short Caspian Select Credit International Ltd. (Board Resolution 2010-40).
 - The \$200 million allocation was made in three tranches with \$50 million effective on March 1, 2011, \$100 million effective on April 1, 2011 and \$50 million effective on May 1, 2011.
- In December 2014, the Public School Employees' Retirement System Board approved a Public Market In-House Co-Investment Program. (Board Resolution 2014-53).
 - A fund-of-one portfolio, Caspian Keystone Focused Fund Ltd., was established and its Class A share class has a max \$75 million in capacity for long-only co-investments, at cost, so long as a \$200 million investment is maintained in the Caspian Select Credit fund.
 - To-date, \$59.5 million was called and \$47.7 million was distributed back to PSERS.
- In September 2018, the Public School Employees' Retirement System Board approved the recommendation of PSERS' Investment Office Professionals and Aksia to invest an amount not to exceed \$200 million in the long-only Caspian Opportunistic Dislocation Strategy. (Board Resolution 2018-48).
 - A Class B share class was added to the fund-of-one portfolio, Caspian Keystone Focused Fund Ltd., to house the Caspian Opportunistic Dislocation Strategy. Class B share class has a max \$200 million in capacity for the dislocation strategy, at cost, so long as a \$200 million investment is maintained in the Caspian Select Credit fund.
 - \$70 million was called in two equal tranches with \$35 million effective on March 17, 2020 and \$35 million effective on March 20, 2020.
 - A total of \$79.9 million was distributed back to PSERS starting from July 2020 with the last dollar returned effective on December 23, 2020.

At March 31, 2022, PSERS' investment in the Caspian Select Credit Fund was valued at \$311.8 million.

At March 31, 2022, PSERS' co-investments with Caspian were valued at \$18.5 million.

Market Opportunity

U.S. high-yield bonds outstanding as of the first quarter of 2022 are estimated to be about \$1.6 trillion, comprising about 16% of the U.S. corporate bond market, which totals \$10.0 trillion. New issuances of U.S. high-yield bonds amounted to \$410 billion in 2021. The issuer count increased 11% in 2021, adding a net 94 issuers and now totals 954.

The Bloomberg US HY Index returned 5.8%, p.a., from August-2011 through March-2022 with a 6.9% volatility, p.a., and a 0.39 beta to the S&P 500.

Fund Investment Strategy

The Fund takes a long-only approach to below investment grade credit across bonds and loans, seeking to generate excess yield by owning "off-index" credits and excess return via capital appreciation, but with limited risk of long-term principal loss. The Fund will allocate to performing, stressed, and distressed corporate credit investments with a primary focus on performing debt via leveraged loans and high yield bonds. The Fund will retain the flexibility to allocate across the entire corporate capital structure and could include investments in total return opportunities such as non-performing credit or distressed opportunities that are consistent with the risk and return profile of the strategy.

Caspian HY is expected to run with a bias toward lower-rated credit and smaller issue sizes, ideally profiting from inefficiencies in such parts of the market. The portfolio has a small allowance for bankruptcy-related situations, such as Debtor In Possession (DIP) loans, but emphasizes capital preservation and a



manageable liquidity profile which will allow for monthly redemptions. The Fund will hedge specific factors such as interest rate or currency risk to enhance the risk adjusted return.

The following table summarizes the investment instruments used across the Fund:

Strategy	Instrument Description
Performing Credit and Stressed Credit	Corporate debt (including investment grade, senior, junior, subordinated, secure and unsecured debt), mezzanine and preferred equity, convertible debt, bank loans (1st and 2nd lien, revolvers, bridge loans and DIP loans, participations, and payment rights agreements).
Non-Performing Credit	The Fund may only hold public or privately placed common equities when received in a bankruptcy, bond conversion, workout or exchange offer, follow-on investment/rights offering to a re-organization, or where stapled to or placed or traded with debt obligations. In addition, the Fund may invest in privately placed equities or trust units when the underlying asset is a bankruptcy creditor claim (trade claims/litigation claims).
Hedges	US Treasury and agency securities, and FX hedges.

PSERS History & Performance

Below figures are since inception through March 31, 2022.

Investment (Vintage)	Commitment/ Capacity	Contributions	Distributions	NAV	Net IRR	Net MoC
<i>Measure</i>	<i>\$M</i>	<i>\$M</i>	<i>\$M</i>	<i>\$M</i>	<i>%</i>	<i>0.0x</i>
Caspian Select Credit	\$200	\$200	\$0	\$311.8	4.1%	1.56x
Caspian Keystone Focused Fund – Class A	\$75 (capacity)	\$59.5	\$47.7	\$18.5	11.4%	1.11x
Caspian Keystone Focused Fund – Class B	\$200 (capacity)	\$70	\$79.9	\$0	31.0%	1.14x
Total:		\$329.5	\$127.6	\$330.3	4.5%	1.39x

Commitments to Keystone Focused Fund – Class A share class and Class B share class are non-binding capacity rights and are pending the Allocation Implementation Committee's and the CIO's approval prior to each funding.

Below is a table outlining IOP's recommendations. Current commitment and the associated estimated Oct 1, 2022 NAV are if the Board does not approve IOP's recommendations and Caspian Select Credit and Caspian Keystone Focused shall be liquidated as per the stated redemption terms. Proposed commitment and the associated estimated Oct 1, 2022 NAV are if the Board approves IOP's recommendations. Please note that PSERS has never been invested in the Caspian Focused Opportunities strategy (long-only high-yield).

Vehicle	Share class	Strategy	Current Commitment	Estimated Oct 1, 2022 NAV	Proposed Commitment	Estimated Oct 1, 2022 NAV
<i>Measure</i>			<i>\$M</i>	<i>\$M</i>	<i>\$M</i>	<i>\$M</i>
Commingled	Caspian Select Credit	Absolute Return	\$200	\$301	\$0	\$0
Fund of One	Caspian Keystone Focused - Class A	Co-Investments	\$75	\$18	\$75	\$18
Fund of One	Caspian Keystone Focused - Class B	Dislocation/Opportunistic	\$200	\$0	\$200	\$0
Fund of One	Caspian Keystone Focused - Class C	Long-Only High-Yield	\$0	\$0	\$500	\$500
Total:			\$475	\$319	\$775	\$518



Portfolio Fit

The Fund will be allocated to the US High Yield sub-asset class of PSERS' Traditional Investments, Credit-Related portfolio where there is a 0.90% underweight versus the Board directed Investment Policy Statement (toggling for Private Credit Overweight); the underweight would be 2.4% versus the Board directed Investment Policy Statement (no toggling). The table below summarizes PSERS' projected exposure inclusive of a recommended \$500 million commitment, as of June 30, 2022:

Sub-Asset Class	Market Value	Unfunded ¹	Total Exposure	%	Pending Current Recommendations		
					August 2022	Total Exposure	%
US High Yield	\$1.1 B	\$0	\$1.1 B	1.61%	\$500 million	\$1.6 B	2.34%
Target Weight in the IPS (toggling for Private Credit Overweight)							2.50%
Target Weight in the IPS (no toggling)							4.00%

¹ UNFUNDED includes all commitments up to last Board meeting and/or notational ballot voting. Include footnote indicating the "as of" date

If the Board approves the full transfer of the fund-of-one with Caspian that is currently held within the Absolute Return asset class, IOP will maintain an additional \$275 million of maximum commitment (capacity) to the U.S. High Yield sub-asset class that can be used to add exposure should the market opportunity arise. As a reminder, these commitments are non-binding capacity rights and are pending the Allocation Implementation Committee's and the CIO's approval prior to each funding.

Investment Highlights

- Negotiated Attractive Alpha Share (outperformance over the index) to PSERS
- Experienced Senior Investment Team
- Have Shown the Ability to Outperform the Index
- Highly Rated in the Consultant's Peer Group, and by Existing Investors
- Favorable Upside v. Downside Capture

Investment / Risk Considerations

- Invested in Smaller Issues and Lower-Rated Credits
- May Have Sector Concentration
- May Experience Staffing Needs with Multiple Bankruptcy Workouts
- Staff Turnover at the Junior Level

Investment Committee Disclosure

Relationship with Aksia:	Aksia does not represent discretionary or non-discretionary clients with allocations to the Caspian Opportunistic Credit Strategy, including the Caspian Focused Opportunities Fund.
Introduction Source:	Existing Relationship
Compliance with Placement Agent Policy:	As confirmed by PSERS' Office of Chief Counsel on [DATE], this investment complies with the Board's policy.
PA Political Contributions:	None Disclosed
PA Presence:	None



Potential Conflicts: On audit committee docket; being looked at by Chuck and awaiting further direction.	PSERS is not aware of any actual or potential conflicts of interest that would be created by PSERS' investment in the Fund.
Litigation Disclosure:	Caspian receives communications from regulators and may be involved in litigation from time to time in the ordinary course of business and to the best of PSERS' knowledge, the Firm and its funds are not involved in any litigation which has or may have a material effect on Caspian or the Fund.
Has the Firm reimbursed and/or paid for PSERS IOP travel in the past two calendar years?	No
Certification of Due Diligence Costs:	IOP certifies that PSERS paid all travel costs, if any, and was not reimbursed for the travel costs related to due diligence of the Fund.